Financial Stability Institute | BIS

Liquidity preparedness for margin and collateral calls – Executive Summary

Recent episodes of market turmoil, eg the Archegos Capital collapse in 2021 or the United Kingdom's liability-driven fund stress in September 2022, showed that rapid increases in margin and collateral requirements, while essential for managing counterparty risk, can amplify liquidity needs across the financial system, especially if market participants are unprepared.

Drawing on an analysis of these experiences, the Financial Stability Board (FSB) identified weaknesses in liquidity risk management, stress testing and collateral practices among the non-bank financial intermediation (NBFI) sector. Key vulnerabilities arise from leverage, concentration risk, operational inefficiencies and a lack of harmonised regulatory frameworks. These issues are exacerbated by the interconnectedness of financial markets, where stress in one sector can quickly spread across the system.

Against this background, in December 2024, the FSB published *Liquidity Preparedness for Margin and Collateral Calls*. This report provides policy guidance to improve NBFI entities' ability to manage liquidity demands from margin and collateral calls in centrally and non-centrally cleared derivatives and securities markets, including securities financing (eg repo) activities. It covers a range of non-bank market participants (ie insurance companies, pension funds, hedge funds, investment funds, family offices and commodity traders) and aims to reduce systemic risks associated with liquidity shortfalls, building on the FSB's ongoing efforts to strengthen the resilience of the NBFI sector.

The FSB's policy recommendations complement existing international standards. Given their cross-sectoral nature, they are high-level and may not apply in the same way to all types of NBFI entities. Proportionality is therefore needed when applying them to the underlying risk of each type of NBFI activity. Standard-setting bodies and national authorities are called to promote the recommendations for their specific sectors and to review whether their respective standards and guidance need revision in the light of the FSB's policy recommendations. The FSB report includes an annex with examples of how recommendations can be applied.

Policy recommendations

Liquidity risk management practices and governance

1. **Integration in risk management and governance frameworks:** Market participants should incorporate liquidity risk from margin and collateral calls in their risk management and governance frameworks. This includes identifying key risk drivers, setting up early warning indicators and assigning responsibilities for decision-making.

2. **Risk tolerances and contingency planning:** Market participants should define their risk tolerance for liquidity risk arising from margin and collateral calls and establish contingency funding plans that are regularly reviewed and tested to ensure liquidity needs can be met in severe scenarios.

3. **Regular review and adaptation:** Liquidity frameworks should be updated regularly. Market participants should actively seek to incorporate all available information to overcome data gaps and account for evolving market conditions, portfolio concentrations and the potential reactions of counterparties. Senior management and competent authorities, where required, should be informed as needed.

Liquidity stress testing and scenario design

4. **Stress testing:** Regular stress tests should be conducted to identify sources of potential liquidity strains caused by margin and collateral calls. Both historical (backward-looking) and hypothetical (forward-looking) scenarios should be included, with attention given to concentrated and leveraged exposures. The results should inform the calibration of liquidity and collateral arrangements and be shared with authorities and, where appropriate, counterparties to facilitate their risk management.

5. **Scenario design:** Stress tests should consider idiosyncratic (institution-specific), market-wide and combined shocks, based on extreme but plausible scenarios caused by changes in margin and collateral calls. Stress tests should also incorporate supervisory guidance and model the market impact of asset liquidations under stress, including on concentrated market segments.

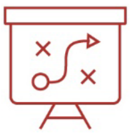
Collateral management practices

6. **Operational resilience:** Market participants should have resilient and effective operational processes and collateral management practices. They should ensure the timely availability, transferability and settlement of collateral, even under stress.

7. **Sufficient and diversified collateral:** Market participants should maintain adequate levels of cash and readily available and diverse liquid assets. They should assess the benefit of diversification in their collateral management (eg in terms of individual issuer, issuer type and asset type). Market participants should incorporate haircuts appropriately.

8. **Active counterparty engagement:** Market participants should interact regularly and actively with counterparties and third-party service providers to ensure mutual preparedness. Agreements should be reviewed and tested to confirm they remain robust during periods of stress or heightened margin demands.

Conclusions and policy considerations



Strategic integration: Market participants should ensure that liquidity risk management for margin and collateral calls is a priority at the board and senior management levels, with clear accountability and regular oversight.

Regulatory alignment: Authorities should assess existing liquidity regulations and supervisory guidance against the FSB's recommendations and fill any identified gaps, especially regarding stress testing and collateral readiness.

Operational readiness: Investments by market participants in risk systems, automation and staff training are crucial to build operational resilience for managing collateral and liquidity under stress.

Stakeholder coordination: Firms should engage proactively with supervisors, clients and counterparties to promote transparency, data-sharing and harmonisation of practices. This is especially important for entities operating across borders or with complex business models.

This Executive Summary and related tutorials are also available in FSI Connect, the online learning tool of the Bank for International Settlements.